97-84040-16

Paton, Thomas Bugard

Opinion of
Thomas B. Paton...

[Philadelphia]

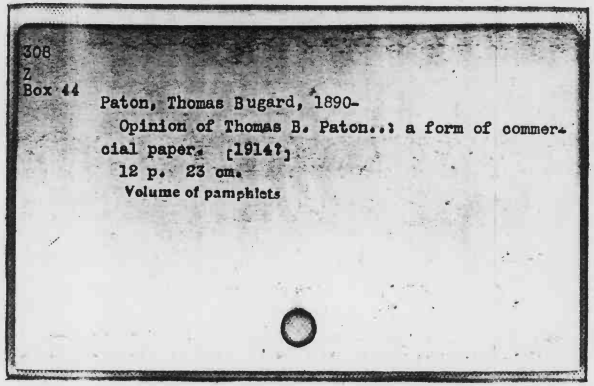
[1914]

97-84040-16
MASTER NEGATIVE #

COLUMBIA UNIVERSITY LIBRARIES
PRESERVATION DIVISION

BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD



RESTRICTIONS ON USE: Reproductions may not be made without permission from Columbia University Libraries.

TECHNICAL MICROFORM DATA

FILM SIZE: 35 mm REDUCTION RATIO: 11:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 3-6-97 INITIALS: MS

TRACKING # : 20937

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

Gift of the President

Opinion of

THOMAS B. PATON, ESQ.

General Counsel

AMERICAN BANKERS ASSOCIATION

308
Z
P264

A Form of Commercial Paper

Sent out with the Compliments of George H. Paine, Philadelphia, Pa.

My dear Sir:—

You request my opinion upon the validity and negotiability of the form of note with attached documents submitted, both under the laws of those states having the Negotiable Instruments Act and those which have not yet enacted that law.

After due consideration, I have formed the opinion that the instrument submitted is valid and would generally be held negotiable under the Negotiable Instruments Act so that a holder in due course could enforce it against the maker free from any defense which he might have against the payee and would also have recourse against the payee as indorser; furthermore, in the event of the insolvency of both maker and indorser he could hold in addition the seller, whose conditional indorsement is appended to the instrument.

I will endeavor to briefly outline the course of legal reasoning which has been followed in reaching the above opinion.

The form of note itself complies with all the requirements of negotiability prescribed by the Negotiable Instruments Act unless the clause which indicates that the note is given for

> "The amount of the invoice of R. H. Foerderer, Inc., number 123 . . . dated Oct. 1, 1914, for Vici Kid, Without defalcation. Value received"

could be construed to make the promise conditional.

One of the requirements of negotiability is that the promise must be unconditional and in this connection the Act provides that "an unqualified order or promise to pay is unconditional within the meaning of this Act though coupled with (1) an indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or (2) a statement of

the transaction which gives rise to the instrument. But an order or promise to pay out of a particular fund is not unconditional."

The question here suggested is whether by any possibility the note containing the clause quoted showing that the amount promised is the amount of the described invoice, would be construed as a conditional promise to pay based upon the existence of the invoice and limited to its proceeds.

I have in mind the case of Hannay v. Guaranty Trust Co., 187 Fed. 686, in which it was held that a draft containing the provision "charge the same to the account of R. S. M. I. 100 bales of cotton" with purported bill of lading attached, was conditional upon the existence of the cotton; that the draft being conditional, the acceptance was also conditional and upon failure of the consideration, the acceptor was not bound to a bona fide holder and could recover the money paid. In a second case between these two parties (Guaranty Trust Co. v. Hannay, 210 Fed. 810), proof of the law of England where this draft was payable and which governed the transaction, was introduced that a draft so drawn was unconditional, and upon such proof the court so decided.

I doubt very much if the courts generally will follow the first decision in the Hannay case—the decision in the second case shows that the law of England is contrary to this and probably the same will be held as to the law of this country—but even conceding the point that the law is uncertain as to the unconditional character of a draft where the amount is chargeable to a described shipment, the situation is certainly different where a promissory note contains an absolute promise to pay and simply indicates that the sum payable is the amount of a described invoice. Here, the promise to pay is not conditional upon the existence of the invoice nor limited to its proceeds but is upon the general credit of the maker. Numerous authorities support the proposition that the mere statement in a promissory note that it is given for a described consideration does not make the note conditional and destroy its negotiability. Space will not be taken for a citation of these authorities.

Then comes the further question whether the attaching to the note of an order to the payee to pay a certain sum out of the proceeds to a specified trust company, simultaneously with the discounting of the note, would impair its negotiability? In this connection, the memoranda also attached must be considered. The note is dated October 1, 1914, and promises to pay $10,000 and this, according to memoranda attached, is the amount of a described invoice also dated October 1st, the terms of which are four per cent. deduction or $9600 if paid within ten days from date. According to such memoranda the manufacturer or seller, R. H. Foerderer, Inc., retains his right to demand payment unless the maker of the note discounts it with a national bank for at least $9600 within ten days from date and, in the order to the bank to pay the trust company $9600 out of the proceeds and simultaneously with the discount, such Foerderer, Inc., is named as the beneficiary for whose account the trust company receives the proceeds.

This it seems to me might be sufficient to indicate to an indorsee of the note that at the time of its delivery the consideration had not been paid over by the payee bank, notwithstanding the order is for simultaneous payment of the proceeds; in other words, that the note is based upon an executory consideration which would raise the question whether its negotiability was thereby affected. True, it might be contended that the consideration for the note is received by the maker at the time it is delivered when presumably the proceeds are placed to his credit by the bank and that the order to simultaneously pay $9600 out of such proceeds and charge to his account is a separate

matter, akin to drawing a check against such account; but the note and the manufacturer's statement of the amount of cash discount and his stated continued right to demand payment until the note is discounted are all coupled together and might be held to indicate or to charge an indorsee with notice that the maker gave his note to the bank for funds to be paid by the bank in his behalf to the seller's agent as the discount for cash price for goods sold and delivered and that although such payment is ordered simultaneously with discount of the note, still it must necessarily be a subsequent act as the discount and creation of proceeds must precede their payment and it is conceivable the bank may discount the note and disobey the order, as is indicated in the order itself; that therefore the note is given for a consideration thereafter to be executed by the payee, which may be the next moment, the next day or not at all.

This may be a debatable position, but in testing the negotiability of this instrument and its enforceability in the hands of an indorsee free from any defense of the maker of failure of consideration, I think it safer to proceed on the theory that the note and attached documents indicate that the consideration for which it is given is executory; something to be done in the future.

There is some little authority to the effect that where a promissory note indicates on its face that its consideration is executory the promise to pay is conditional upon the performance of the executory agreement and where, apart from the note, the indorsee has knowledge that the consideration is executory, he is not a holder in due course, even though he has no notice of the non-performance of the executory agreement. But the great weight of authority is to the contrary.

Referring briefly to the first class of cases, in Equitable Trust Co. v. Newman, 129 N. Y. Supp. 259, reversing 127 N. Y. Supp. 243, a promissory note in the form of a

letter promising to pay a stated amount as annual premium, contained the following request from maker to payee: "you are hereby authorized and requested to place the said policy in force from this date." In an action by an indorsee against the maker involving the question of negotiability of the instrument and its enforceability free from equities, the maker contended that the clear intention of the instrument was that something was to be done by the payee after the maker received the policy, in order to put it in force, and that on condition of that being done, the maker would pay; therefore, the promise was conditional. The court took this view, holding that the instrument was not intended to be a present unconditional engagement but was conditional upon the agent performing his part of the contract. However, some weight was placed on the fact that the instrument was in the form of a letter and not of a note and still later in Equitable Trust Co. v. Taylor, 131 N. Y. Supp. 475, involving a similar form of note or letter, the court differed from the view adopted by the Appellate Term in 129 N. Y. Supp. and held that the words "you are authorized and requested to place the said policy in force from this date" contained in the promise to pay, so far from imposing a condition may be regarded as mere surplusage, for the policy of insurance had already been delivered and the agent had paid the full premium thereon.

It was also held in Heard v. Shedden, 113 Ga. 162, that where the consideration is an insurance policy not yet issued, a purchaser who takes the note with notice that such policy has not yet been issued takes the risk of possible failure of the company to issue such a policy as is applied for.

And in Sumter Co. State Bank v. Hayes, 67 So. 109, recently decided by the Supreme Court of Florida, where a negotiable note was given and indorsed by the payee to plaintiff bank and it appeared from the facts outside the note that it was given in consideration of an executory con-

tract, and the bank acquired the note with knowledge that such was the consideration but before there was a breach of such contract, it was held that the indorsee was not a holder in due course, without notice of any infirmity in the instrument or defect in its title within the meaning of the Negotiable Instruments Act, even though the indorsee did not know of the subsequent breach of the contract.

But despite the few cases to the above effect, the great weight of authority is as stated in Daniel on Negotiable Instruments, Section 795b (6th Edition) that "it is not a good ground of defense against a bona fide holder for value that he was informed that the note was made or the bill accepted in consideration of an executory contract, unless he was also informed of its breach. If he has such knowledge he cannot recover." (Citing numerous cases.)

It has also been expressly held in Iowa under the Negotiable Instruments Act that knowledge that a note was given in consideration of an executory agreement or contract of the payee which has not been performed, will not deprive the indorsee of the character of a bona fide holder unless he also has notice of the breach of the agreement or contract. McKnight v. Parsons, 136 Ia. 390.

Without further reference to this line of cases, the language of the Supreme Court of Missouri in Jennings v. Todd, 118 Mo. 296, in which the court distinguished between notice of a condition to be performed and knowledge at time of purchase of a breach of such condition, may be quoted: "We think, however, that no well considered case can be found in which a collateral contemporaneous agreement, providing that the note should not be paid in the event that an executory contract, which was consideration of the note, should not be performed, has been allowed to defeat the negotiability of the note in the hands of an indorsee, though he had notice of such agreement. A great part of the improvement of the country, and of business

generally, is carried on with money raised by the discount of notes given upon executory contracts, and if the maker could be allowed to defend against such notes, in case of a breach of contract, on the ground that the indorsee, though in other respects bona fide, had knowledge of the transaction out of which the notes grew, all confidence in such notes as negotiable paper would be destroyed and such business would be paralyzed. By making and delivering a negotiable note the maker is held to intend that it may be put in circulation and that no defenses against it exist. . . . If the breach had occurred to the knowledge of the indorsee when he purchased, he would not, of course, be protected."

In view of the weight of authority it is my opinion, therefore, that the instrument under consideration would be generally held negotiable under the Negotiable Instruments Act even though the order to pay part of the proceeds coupled with the memoranda attached were held to carry notice that the note is based on an executory consideration. Of course, if the view was taken that the documents conveyed no such notice, the note would be negotiable in any event. Hence should a case arise where, after discounting the note, the bank failed or refused to pay over the amount as ordered to the financial agent of the seller these facts of failure of consideration could not be interposed as a defense against a holder in due course. There might be some exceptional case where a court, taking the view that the indorsee had knowledge that the consideration was executory, might hold, as did the Supreme Court of Florida, that such knowledge deprived the indorsee of the status of a holder in due course where there was a subsequent failure of the consideration; but in view of the great weight of authority the other way, I think for all practical purposes, the form of note and documents may be dealt in as negotiable paper.

The two certificates attached to the note, having reference to the invoice, do not in any way affect its negotiabil-

ity. They do not inject any condition into the absolute terms of the note.

The note has an attached document signed by the manufacturer stating the terms of the invoice and containing a conditional engagement that (a) if the maker discounts the note on or before October 10, 1914, with a national bank for at least $9600, the net amount of the invoice, and (b) if the bank negotiates the note with its unqualified indorsement and (c) if both bank and maker become insolvent, then the subscriber assumes an indorser's liability with waiver of protest to any holder in due course subsequent to said bank. This does not affect the validity or negotiability of the note but is in the nature of an added guaranty of payment to a holder in due course upon certain conditions. Should some court in a case where the consideration failed hold that the indorser had knowledge that the note was executory and that such knowledge deprived the indorsee of the status of holder in due course, this added guaranty might not be enforceable as it runs only to a holder in due course. But this would be exceptional.

The Negotiable Instruments Act is in force in every State of the Union with the exception of Maine, Georgia, California, Texas and Mississippi. As already said, I think the instrument would be generally held negotiable under this Act, excepting possibly in the State of Florida.

Taking the states which have not yet adopted the Negotiable Instruments Act, in California, there is a distinctive code of the law of negotiable instruments which is based on the law merchant as is the Negotiable Instruments Act and I believe the note in question would be held to have the same legal effect under the law of California as under the Negotiable Instruments Act. Also, in Maine, where the law merchant has not yet been codified, the same conclusion is warranted. And in Texas it has been expressly held that knowledge that a note is based on an executory contract

does not prevent a bona fide holder from enforcing it free from equities where he takes without knowledge of a breach of such contract. Buchannan v. Wren, 10 Tex. Civ. App. 560.

But in Georgia, the courts incline to the view that knowledge of an executory consideration charges an indorsee with notice. In addition to Heard v. Shedden, supra, is the case of Harris v. Nicholls, 26 Ga. 413, where it was held that failure of consideration may be pleaded against a transferee who took the note with knowledge of the contract and that the consideration was liable to fail.

In Mississippi, furthermore, there exists what is known as an Anti-Commercial statute. The Code of Mississippi of 1906, Sec. 4001, provides in substance that in actions upon promissory notes by an indorsee, whether payable to order or not, the defendant shall be allowed the benefit of all defenses previous to notice of assignment in the same manner as though the action had been brought by the payee. Under this statute, therefore, the maker of the note in question could interpose the same defense, if he had any, against a transferee of the payee as he could against the payee. But a promissory note executed in but payable out of the state, is not within the statute. Emanuel v. White, 34 Miss. 56. It has also been held in Mississippi that a note payable to bearer is not within the statute. Craig v. Vicksburg, 31 Miss. 216; and that a note payable to the maker's order and by him endorsed in blank before delivery is in effect payable to bearer, and therefore, not subject to this section. Bank v. Wofford, 71 Miss. 711.

So far as Mississippi is concerned, therefore, apart from any question of the effect of knowledge by an indorsee of an executory consideration, and looking at the form of note itself, irrespective of the order and the other attached documents, it would not be negotiable in its present form unless it was made payable out of the state; if executed and

made payable within the state it would be transferable subject to equities under the peculiar statutory law of that state and would require reframing so as to be made payable to the maker's order and indorsed in blank by him.

This letter has reached considerable length but it has seemed necessary in order to consider the negotiability of the note and attached documents submitted from all the various view points. It has seemed to me that the documents attached to the note might very likely be held to convey notice to an indorsee that the promise of the maker to pay was based on an executory consideration and from this view point it has been necessary to consider at length whether, assuming such knowledge was possessed by the indorsee, it would be sufficient to deprive him of the status of a holder in due course where there was a subsequent failure of the consideration. As shown, the courts generally take the view that such knowledge does not affect the bona fide holder where he has no knowledge of the breach of the executory contract and this leads to the conclusion that, even chargeable with knowledge that the consideration of the note is executory, the instrument would nevertheless be negotiable and enforceable by an indorsee free from equities except possibly in Florida where a contrary view has been taken under the Negotiable Instruments Act and in Georgia where a similar view has been taken under the law merchant. But if the view be taken that the note and documents carry no notice of an executory consideration, then it is negotiable everywhere, except in the State of Mississippi, where, as shown, the Anti-Commercial statute would operate against it.

Very truly yours,

THOMAS B. PATON,
General Counsel.

MSH 20937

END OF
TITLE